COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES

Massachusetts Electric Company	)))	D.P.U. 96-25

REPLY BRIEF OF THE CENTER FOR ENERGY AND ECONOMIC DEVELOPMENT

INTRODUCTION

The Center for Energy and Economic Development ("CEED") submits this Reply Brief to the Department of Public Utilities ("DPU" or the "Department"). CEED responds to the initial briefs of Massachusetts Electric Company ("MECo" or the "Company"), the Attorney General ("AG"), the Division of Energy Resources ("DOER"), the Conservation Law Foundation ("CLF") and the Union of Concerned Scientists ("UCS"). We refer to these parties as the "Proponents." CEED's brief is limited to the emission reduction and renewable resource provisions of Part III of the Restructuring Settlement Agreement ("RSA").

ARGUMENT

I. THE EMISSION REDUCTION PROVISIONS OF THE RSA ARE NOT IN THE PUBLIC INTEREST AND EXCEED THE AUTHORITY OF THE DPU TO ADOPT.

A. The Emission Reduction Provisions of the RSA Would Result in Increased Stranded Cost Borne by Ratepayers.

As predicted in CEED's initial brief, the initial briefs of the Proponents all claim that the "deep and expensive" emission reductions required by Attachment 10 of the RSA will not actually cause prospective buyers to lower the price they will offer for the Brayton Point and Salem Harbor Units. Indeed, we are even urged to believe that prospective buyers will conclude that the value of those units is <u>increased</u> (!) by the requirement that, once the units are purchased, the buyer must undertake "deep and expensive" emission reductions at its newly acquired units. MECo brief at 29; DOER brief at 7; CLF brief at 6-8.

The argument that the emission reduction provisions of the RSA will not reduce the market value of the units is based on testimony of Mr. Brick on behalf of the CLF. According to Mr. Brick, as characterized in CLF's brief at 6, "a prudent buyer will take the risk of future environmental regulations into account in making its bid for the Salem Harbor and Brayton Point units." In other words, according to Mr. Brick, Attachment 10 of the RSA will not cause prospective buyers to lower their bids because, assuming Attachment 10 were not adopted, buyers would assume anyway that equivalent emission reductions will be required in the near future by environmental regulators.

Mr. Brick's argument, however, ignores several key points.

<u>First</u>, it is not at all true that prospective buyer will necessarily assume that the "deep and expensive" emission reductions set forth in the RSA will be required by environmental regulators even if Attachment 10 is not adopted. In fact, the emission reductions proposed in the RSA are considerably more stringent than anything now proposed or reasonably expected from environmental regulators. In particular:

- The "Memorandum of Understanding" proposed by the Ozone Transport Commission would reduce NO_x emissions only in the ozone season whereas Part III of the RSA would reduce NO_x emissions year-round. As a result, the RSA would require considerably greater expenditures on NO_x emission reductions than contemplated by the MOU. CEED-1 at 3-4.

- EPA's preliminary forecasts are that Massachusetts would presently be in compliance with EPA's recently proposed fine particle standards, assuming that standard is ultimately adopted into law. CEED-3 at 6. Thus, adoption of that standard would not require SO_2 emission reductions by Brayton Point and Salem Harbor. However, Part III of the RSA requires deep SO_2 reductions at those units.

- Part III of the RSA would require emission reductions at a much earlier time than would be required under EPA's proposed regulations. Thus, even assuming EPA's proposed fine particle and ozone regulations, if adopted, would require emission reductions at Salem Harbor and Brayton Point, the date those reductions requirements would become effective would not be until considerably after 2000, and probably not until 2005. Yet the emission reduction provisions of the RSA would require emission reductions at all four Salem Harbor units by 2000. CEED-3 at 5-6.

Second, as Mr. Hewson testified, there can never be a case where the environmental provisions of the RSA result in less emission reductions than will potentially occur under future environmental regulation. It is reasonable, therefore, to conclude that the market will view the emission provisions of the RSA as creating substantial risk that those provisions will, in fact, be more strict than would otherwise obtain under environmental regulation. That risk will be reflected in a reduced price for Brayton Point and Salem Harbor. CEED-3 at 3-4.

Third, while feigning to the contrary in their briefs, the Proponents, in fact, think that it is considerably less than certain that environmental regulators will adopt emission reduction requirements of the magnitude set forth in Attachment 10. Otherwise, the Proponents would not have thought it necessary to use the RSA as a vehicle to lock in "deep and expensive" emission reductions now. And if the Proponents know that emission reductions are uncertain, so do future buyers of NEP's assets.

Fourth, the phrase "prudent buyer" as utilized by Mr. Brick has no meaning in a deregulated market environment. In a regulated environment, it is at least arguable that it may be economically prudent for a utility to make emission reductions in advance of being required to do so by environmental regulators. Given regulation, utility expenditures of money now on emission reductions may, under certain circumstances, save money in the future for the utility and its ratepayers.

But, given deregulation and divestiture as envisioned in the RSA, there is no ratepayer interest protected by Attachment 10 of the RSA. No utility commission will be looking over the buyer's shoulder when it bids for NEP's generating assets to determine that the bid is "prudent." What a buyer will or will not bid for those assets will be a matter of market conditions - and how individual bidders assess those conditions. If the buyer of NEP's assets makes an "imprudent" (meaning "wrong") judgement with respect to any factor concerning the value of the units, that buyer alone will suffer the consequences. Its costs will rise, and it will be less competitive in selling electricity in the market. The ratepayers, however, will be insulated from the buyer's imprudent decision because they can purchase alternative sources of electricity at market prices.

And that is precisely why the RSA is contrary both to the public interest and to this Department's policy providing that the market risk of future environmental regulation should not be placed on ratepayers. As discussed in more detail in CEED's initial brief, the RSA removes the risk of prudent decisionmaking with respect to emission controls from MECo and the buyer - where that risk belongs in a deregulated environment - and places the risk squarely on the ratepayers. Because if Mr. Brick is wrong about the risk of future regulation (and about how the market assesses that risk), it is the ratepayers who will pay the cost in increased stranded investment.

Additional arguments made by the Proponents to justify the emission reduction provisions of the RSA are equally unavailing. Some of the Proponents argue that, even if Attachment 10 will increase stranded cost, it will not increase such cost by $150 million as predicted by Mr. Hewson. In the view of these parties, Mr. Hewson's figure is inflated because he did not include "any credit for the retirement of the units at the end of their forty year lives." MECo brief at 28; CLF brief at 7.

The import of this argument is that a purchaser of Brayton Point and Salem Harbor may buy the units in order to shut them in, a proposition which is absurd on its face. We would remind the Proponents that the whole debate with respect to the effect electric restructuring will have on the environment is driven by the belief that, with competitive forces unleashed, older coal plants will not be retired at their 40-year anniversary dates and will continue to operate into the indefinite future. This is an argument that the Proponents and allied interests have made over and over again in a variety of forums. Indeed, Salem Harbor is forty years old in 2000, and the last internal projection MECo made, prior to agreeing to divestiture, was that NEP would run the units indefinitely past 2000 with increasing capacity factors. CEED-2-4. Thus, it does not seem likely, to say the least, that a buyer will purchase Salem Harbor and Brayton Point with the idea of shutting them in to obtain emissions credits.

Finally, the notion that Attachment 10 might actually enhance the value of Salem Harbor and Brayton Point - because of the "certainty" the settlement provides - is equally absurd. Attachment 10 specifically provides, in its very first paragraph, that "[a]s implemented, the program will not supersede any environmental agency's legal authority to regulate the units nor require the units to meet emission standards other than the most stringent applicable standards required by law." In other words, the RSA provides no certainty whatsoever for the new buyer of Brayton Point and Salem Harbor with respect to the level of emission controls it will be required to make. If emission reduction requirements more stringent than those set forth in the

RSA are established by environmental regulators, the new owner of Brayton Point and Salem Harbor will be required to meet those requirements regardless of the existence of the settlement. No buyer, therefore, will consider the value of the units enhanced by the RSA.

In sum, despite the Proponents' pretense to the contrary, it is perfectly obvious that Attachment 10 of the RSA will result in lowering the purchase price received for Salem Harbor and Brayton Point and, therefore, in an increase in stranded cost borne by ratepayers. Attachment 10, therefore, is contrary to the Department's own policies and the public interest and should be rejected.

B. The Emission Reduction Requirements of the RSA Exceed the Authority of the DPU to Adopt.

Several points concerning the authority of the DPU to adopt Attachment 10 of the RSA are raised in the Proponents' initial briefs.

First, the CLF brief at 2 contains a discussion of the RSA that confirms CEED's view that the RSA requires the DPU to consider environmental factors in violation of Massachusetts Electric Company v. Department of Public Utilities, 643 N.E. 2d 1029 (Mass. 1994) ("MECo v. DPU"). CLF writes, in language that is echoed in the briefs of all of the Proponents:

> The Settlement, as is true generally of agreements between parties with widely diverging interests, represents a complex set of compromises and multiple exchanges of consideration. As such the Settlement, or at least the portions of the Settlement that the parties have agreed are conditions of its approval, necessarily must be

> considered as a whole -- the component parts cannot be analyzed separately from one another, as though there were some alternative settlement agreement on the table for review. See Rec. at 2-200-202. It was this particular Settlement which brought all the signatory parties together. [Emphasis in original, footnotes omitted.]

In a footnote, CLF reiterates that the environmental requirements of the RSA are a condition of the agreement. Id.

The above-quoted statement is a tacit admission that the environmental benefits of the settlement are a necessary part of the entire agreement. Those benefits cannot be separated out, according to CLF, and considered separately from the agreement as a whole. In CLF's view, in order for the DPU to determine that the agreement is in the public interest, it must consider all of the benefits of the settlement, including the environmental benefits. But, as noted in CEED's initial brief, consideration of environmental benefits is invalid under MECo v. DPU.[1]

Second, the fact that the Proponents are arguing that the agreement is in the public interest specifically because it is a settlement[2] further infects the document under MECo v. DPU. The necessary implication of the Proponents' argument in this regard is that the portions of the RSA that are clearly within this Department's jurisdiction - such as stranded cost - are in the public interest because of compromises and benefits obtained in

[1] Footnote 17 on page 21 of the AG's brief confirms that the Department may not consider environmental factors in making its decision.

[2] See MECo brief at 4-5; AG brief at 4; CLF brief at 2.

other areas of the RSA - including environmental benefits.[3] In other words, it is being argued to the DPU that full stranded cost recovery is in the public interest, at least in part, because it is part of a settlement that achieves improved environmental quality. But, as seen, DPU may not under MECo v. DPU approve the stranded cost provisions of the RSA based on environmental quality benefits.[4]

Third, the AG's brief at 20 argues that the DPU can approve the RSA under MECo v. DPU because the Department has authority under that decision "as a rate regulator to include in utility rates `reasonable costs to be incurred in protecting the environment, whether mandated or voluntary.'" The AG's brief at 20-21 goes on to say that the emission reduction costs of the RSA are reasonable because they "are not likely to raise ratepayer costs above the level expected as a result of tighter future environmental regulation."

There are two problems with this analysis. As an initial matter, as seen, the emission reduction requirements of the RSA are considerably more stringent and, therefore, more costly than will result from expected environmental regulation.

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[3] Indeed, the AG's brief at 4 states that the AG opposes full stranded cost recovery but is willing to accede to such recovery because it is part of a settlement.

[4] In this regard, MECo testified that it would not have "volunteered" emission reductions unless it was assured full stranded cost recovery. Tr. vol. 2, p. 200, line 20 to p. 202, line 4. The two issues are inextricably intertwined.

More fundamentally, as also seen, given divestiture there can be no economic justification for the emission control provisions of the RSA. No ratepayer interest is served by making the purchaser of NEP's assets pay more money now for emissions reductions on the assumption that ratepayer money will be saved later when emission controls are tightened. In a deregulated environment the price of electricity sold from Salem Harbor and Brayton Point will not be based on the cost of operating those units, whether those costs are considered to be "reasonable" or "prudent" or otherwise. As the Proponents point out, the price will be based on the price prevailing in the market.[5]

In short, the only purpose of the emission reduction provisions of the RSA is to create environmental benefits for society at large.[6] Those provisions, therefore, must fail under MECo v. DPU.

II. THE RENEWABLE RESOURCE PROVISIONS OF THE RSA ARE CONTRARY TO THE PUBLIC INTEREST.

The Proponents launch a number of attacks against the testimony of CEED witness Hewson with respect to the renewable resource provisions of the RSA. The underlying theme of these attacks is that renewable resources are really not that expensive after all. Before examining the specific arguments made by the

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[5] See MECo brief at 29; CLF brief at 8-9; DOER brief at 8-9.

[6] In fact, the Proponents come right out and argue that the RSA should be adopted because of its environmental benefits to society at large. CLF brief at 9-10.

Proponents, CEED recommends that the Department keep several things in mind:

First, as noted in CEED's initial brief, putting aside the renewable resource provisions of Part III of the RSA, ratepayers under the RSA are being stuck with nearly **$1.5 billion** (!) in over market payments just for the minuscule portion of MECo's resource portfolio comprised of its existing commitments for landfill, refuse, biomass and wind resources. CEED initial brief at 25.

In addition, this gigantic expenditure of resources does not seem to have resulted in very much benefit at all. Indeed, the whole purpose of the 4% renewables goal recommended in the RSA stems from the fact that the Commonwealth, in the Proponents' view, is lagging in its commitment to renewables.

Finally, whereas the UCS brief at 4-6 cites renewable resource price forecasts from various sources, no one really knows for sure what the cost of "clean" and "advanced" renewables will be five, ten and fifteen years into the future. All admit, however, that these costs will be over market. Thus, a commitment to a certain quantity of renewable resources in the future - such as the 4% goal recommended in the RSA - is a commitment to some unknown amount of continuing subsidy for renewables, with ratepayer money at risk. And if the past is prologue, the ratepayers will end up with a huge bill for little discernible gain.

CEED turns now to the specific arguments directed by the Proponents against Mr. Hewson's testimony.

First, UCS's brief at 2 contends that, Mr. Hewson's testimony notwithstanding, meeting a 4% goal would cost ratepayers only one to two mills per kwh. CEED disputes that assertion (see Mr. Hewson's testimony, CEED-1 at 14-16), but it needs to be highlighted that the one to two mills to which UCS refers is one to two mills spread over all of the kwh sold to all Massachusetts ratepayers from all resources. Two mills multiplied by all kwh sold to Massachusetts ratepayers today exceeds $100 million per year in subsidy for renewables. Moreover, UCS comes right out and admits that its one to two mills forecast is based on an "assumed ... optimistic cost for a renewables portfolio." UCS brief at 5-6. If the optimism is not justified, the result will be more than $100 million per annum in subsidies.

Second, the Proponents criticize the portion of Mr. Hewson's testimony that described the environmental impacts of renewable resources. The Proponents all claim that the RSA would only fund "clean," non-polluting technologies. UCS brief at 3; CLF brief at 13; DOER brief at 10.

But the Proponents both miss the point of Mr. Hewson's testimony and place themselves on the horns of the proverbial dilemma. If the 4% goal of the RSA could be met only by "clean" and "advanced" technologies, then many of the technologies that

MECo purchases today could not count towards that goal. In fact, the great majority of the current non-hydro "renewable" resources purchased by MECo today (the ones resulting in almost $1.5 billion in stranded cost) - derive from the burning of biomass and municipal solid waste, and these resources produce emissions equal to or greater than fossil fueled plants. CEED-1 at 12-13.

But if we eliminate the great majority of the renewable technologies that MECo is purchasing today from contributing to the 4% goal, then the Commonwealth's ratepayers are on the hook for the purchase of both more and considerably more costly renewable resources. If resources such as fuel cells and "low emission advanced biomass power technologies like gasification" (UCS brief at 3) are supposed to be making a substantial contribution to meeting the 4% goal, then the Commonwealth is looking at billions of dollars more in renewable subsidies.

Third, the Proponents criticize Mr. Hewson's testimony that renewables could cost 7.5 cents per kwh more than conventional power. UCS brief at 4-5; DOER brief at 11; CLF brief at 13-14. Mr. Hewson's testimony was based on his projection of renewable prices of 7 to 15 cents per kwh versus prices for conventional electricity of 2 to 3 cents per kwh for existing resources and 3-5 cents for new resources. CEED-1 at 15.

As an initial response to this testimony, the Proponents claim that conventional generating costs should be considered to be 4.2 cents per kwh for combined cycle gas and 5.1 cents per kwh for AFBC. UCS brief at 4-5. CEED would not quibble with these figures, but they miss the point. It was stated over and over again at the hearings that New England has substantial surpluses of existing generation. See, e.g., Tr. vol. 2, p. 219, line 9 to p. 221, line 1. Indeed, as noted above, the whole basis for the claim by the Proponents that electric restructuring will cause environmental impacts is that existing plants will not be retired and that a whole new source of supply of cheap electricity in the Midwest will become available. Thus, in determining how much renewables are over market, we deal with a market saturated with power available at 2-3 cents per kwh. CEED-1 at 15. Such a view is consistent with MECo's own projections.[7]

The Proponents also attack Mr. Hewson's testimony that renewables will cost 7-15 cents per kwh, claiming that landfill gas facilities already on line cost 5.98 cents per kwh and wind resources have been committed (although they are not yet operational) for 5.1 cents per kwh.[8] UCS brief at 4-5; DOER

[7] See page 34 of the "Workpapers of M.E. Jesanis Supporting Contract Termination Charges," attached to Union 1-1.

[8] Wind resources are often the "poster child" for renewable resource advocates because they are now lower priced than other renewable resources. The UCS brief, in particular, has a good deal of discussion of the existence of Class 4,5 and 6 wind resources in New England. UCS brief at 5-6. Mr. Hewson's testimony never disputed (in fact recognized) that there are wind resources of this magnitude in New England (but not in Massachusetts). CEED-1 at 15. The question remains, however, whether these resources are commercially developable. CEED assumes that the wind resources already in place are located at the best wind sites in New England. Such resources have produced power substantially over market.

brief at 11. However, MECo is currently purchasing some landfill gas resource at rates as high as 13 cents per kwh. See pp. 70-71 of Book 2 of MECo-1. Similarly, the wind resources currently under contract to MECo will be at 8 cents per kwh in 2001, escalating under contract to 13 cents. Id.[9]

Moreover, Mr. Hewson's testimony that renewables cost 7-15 cents per kwh was not drawn out of the air or even from the CEED study that the Proponents criticize.[10] It was verified by the actual contracts MECo has executed. These include contracts for power generated from refuse and biomass plants which exceed 10 cents per kwh. Id. Of course, these are not the "clean" and "advanced" technologies that would qualify under the RSA. Those technologies would cost more.

Fourth, the Proponents argue that adoption of the 4% goal would not commit the Commonwealth to continued spending on renewables past 2001 because the goal is non-binding. UCS brief

[9] Of course, the cost of existing conventional resources in the market could escalate also. However, the cost of conventional resources available in the market has been declining with the introduction of market forces in the industry. And the whole point of the RSA is to induce further price declines.

[10] A great deal of the briefs of the Proponents deal with forecasts of renewable resource prices over the next ten to twenty years, including conflicting forecasts made in a CEED study and an NREL study. UCS brief at 4, 5-6; DOER brief at 11; CLF brief at 12-13. Both the CEED and NREL studies are in the record, and the reader can make its own judgment. However, these studies and others cited in the Proponents' briefs are based on national numbers and, by their very nature, are uncertain. The cold, hard facts are contained in the substantially over market renewable contracts already in place and the bankruptcies and foreclosures plaguing the renewables industry. CEED-1 at 14-15. Any implication in the briefs of the Proponents that the renewables industry is on the verge of taking off is simply wishful thinking.

at 4. But, obviously, the Proponents recommend the 4% goal for a reason. And that reason is to obtain a declaration, one that cannot be easily backed away from in the future, that a defined portion of the market will be reserved for renewables. As noted in CEED's initial brief, such a declaration would be directly contrary to Department policy set forth in D.P.U. 96-100 opposing "approaches that require regulatory intervention to maintain a particular level of renewables in the market." CEED brief at 26.

Moreover, it is not sound public policy to commit the Commonwealth to a goal where the cost of obtaining that goal is of such magnitude and the benefits are so minor. As stated in CEED's initial brief, at a certain point renewables have to compete on their own. It may be that restructuring, which will allow consumers to pay more for renewable power if they so choose, will be just the boost renewable resources need. In any event, however, the four year funding period set forth in the RSA ought to be sufficient time for the transition. After that, renewables must be made to compete on their own.

In sum, the renewable resource provisions of the RSA are not in the public interest and should not be adopted.

CONCLUSION

In conclusion, CEED submits that Part III of the RSA is not in accord with the public interest and, in the case of the emission reduction provisions, exceeds the authority of the DPU to adopt. If the RSA is adopted by the DPU, Part III should be stricken.

Dated: December 23, 1996 Respectfully submitted,

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